Northern and Central Gas Corporation Limited

ANNUAL MEETING, APRIL 27, 1971
Toronto, Ontario

Address to the shareholders
by Edmund C. Bovey
President and Chief Executive Officer

Ladies and Gentlemen:

Once again it is my privilege to address shareholders at this the 17th annual meeting of Northern and Central Gas Corporation Limited and to review with you the progress of the company.

1970 was a year of excellent progress for Northern and Central despite the difficulties experienced by many sectors of the national economy during the period.

As we are all aware, measures adopted by the government in 1970 to curb inflation were designed to slow down corporate expansion – and indeed all forms of spending – as the necessary price for preserving the purchasing power of our incomes. These measures aroused considerable debate in our society concerning their efficacy.

I would like to suggest, however, that the fiscal and monetary policies pursued by government might be better understood if they were considered as an indication of the need for industry, labour and government to improve their own efficiency. This is a prime requisite for balanced and sustained individual and collective growth. Viewed within this perspective, these measures of government were, in my opinion, generally well advised and necessary, lest the profits of corporations and the earnings of Canadians proved to be artificial indicators of a prosperity which was, in fact, being adversely affected by inflationary influences.

One measure, however, the freeing of the Canadian dollar, has had some serious negative repercussions, particularly in the resource industries which are so important to Canada's economy. The pulp and paper industry has suffered a severe set back which, if allowed to continue, could have very unfavourable effects on many areas of the country. The government must address itself to this problem.

Unfortunately, the government's policies have also adversely affected the employment picture in Canada. Obviously, someone who at this time is himself unemployed, will find it difficult to view such policies with detachment however beneficial they may prove in the future. This situation has

been further complicated by regional disparities, with unemployment in some communities far greater than in others.

Hopefully, our economy has now adjusted to the priorities of orderly expansion. Interest rates have fallen considerably in recent months, a development which has assisted in providing Canadian corporations with the necessary funds to finance their continued growth.

Gains in 1970

In 1970, management of Northern and Central Gas Corporation placed increased emphasis on internal operations aimed at reducing controllable costs and increasing the return on investment. These efforts, we are pleased to report, have met with considerable success and have contributed to higher earnings for the company.

As noted in the corporation's latest annual report, total revenues rose 8.8% in 1970, to $172.6 million, compared to $159 million in 1969. Net income, applicable to the common shares, increased 20% to $11.4 million against $9.5 million last year.

Basic earnings per common share increased 11.5%, from 79¢ in 1969 to 88¢ in 1970, after giving effect to the issuance of an additional 1,325,000 common shares during 1970.

Dividends were increased in 1970 on an annual basis from 57½¢ per common share to 60¢ per share – an increase which I am sure meets with your approval.

It is hoped that the appreciation in the market value of the company's shares has also been a source of satisfaction to our shareholders. At this time last year, we were all concerned about the trading levels of the company's securities. Since that time, the price per common share has moved from $11⅞ per share to present levels of about $15½ to $16½ per share. It is hoped this upward trend will continue.

The charts to the left and right of me show the growth of the corporation's sales, earnings and dividend payments over the past ten years.

Contributing to the increases in revenues and profits in 1970 was the favourable effect in the last quarter of the rate increases received in the Manitoba and Quebec utility service areas. Another factor was the strengthening of the company's management structure, designed to provide

for considerable autonomy among the divisions in the conduct of daily affairs while more clearly establishing the lines of executive responsibility and communication. Corporate policy is formulated at the head office in consultation meetings with division heads.

Financial Position

Northern and Central considerably strengthened its financial position during 1970. By comparison to 1969, when the company had bank loans and short term borrowings of approximately $75 million, it now has no outstanding short term debt. In fact, at present the company has over $10 million in surplus funds invested in short term securities. As reported previously, this was accomplished through a combination of long term debt financing and a 1,325,000 share equity issue in the U.S. This financing done in 1970 was in line with our objective of keeping the ratio of equity and debt in balance for the greatest benefit to customers and shareholders. For the next two years it would appear that an efficient and discretionary balance can be maintained without further equity distribution.

Foreign Ownership

Your management has given considerable thought and attention to the subject of foreign ownership of Canadian corporations. In our opinion, corporate policy should be based on as much equity participation as possible by Canadian investors, but also should recognize that, at times, limited participation in equity issues by non-Canadian investors may be advantageous. It would seem that the sale of debt securities to non-Canadians offers no problem in regard to foreign ownership, although we believe that Canadian buyers should, whenever possible, be given first opportunity to purchase providing they are competitive.

In effect, this approach welcomes foreign capital to assist in financing Canadian growth while at the same time providing for maximum equity participation by Canadians in their own corporate enterprises. A policy along these lines is, I believe, consistent with popular opinion here in Canada and seems to offer a sound and viable solution to foreign ownership of Canadian indus-

try. To prosper we must be the primary beneficiaries of our efforts, but we must also recognize the dangers of an economic nationalism carried to extreme.

Our young people were among the very first to engage businessmen and politicians in discussions on this issue of domestic ownership and, for this reason, we owe them credit. In addition, their outspoken concern over environmental preservation long before it became the popular fashion, suggests that our new generation of young people may indeed have much to say which some of us, as adults, are slow to recognize.

In brief, it is what is between the ears of young people which should garner our attention and not what covers them!

I hope that Canadian businessmen will, in the summer ahead, tap the reservoir of young talent which will be available. This form of communication between the "establishment" and Canada's youth can only lead us to a better understanding of the problems which we must collectively face and overcome in the years ahead.

I believe that a program of government assistance to industry, through tax incentives, would be the most effective approach to the task of providing summer work to students, since it will ultimately be industry which will provide the majority of jobs. It would seem that efforts of government would be most productive when channelled through industry itself.

Utility Divisions

Once again, turning to the operations of the corporation, I am pleased to report that, in 1970, the utility divisions experienced considerable growth in combined sales and earnings as well as in improved market penetration. The cost reduction and profit improvement programs, initiated in the latter part of 1969, have clearly demonstrated their effectiveness and have been continued in the current year.

Complementing these undertakings was a program of rationalizing return on all capital expenditures and investments made. Capital expenditures, which have been at levels of approximately $40 million in 1968-69, were less than $20 million in 1970, reflecting considerations of maximizing revenues from existing facilities. Consequently,

only those capital projects offering rates of return commensurate with prevailing financing costs were undertaken in 1970.

In the utilities, combined revenues in 1970, including liquefied natural gas sales, were $139,719,000, up 12% over last year. Net income rose 22% to $8,658,000.

The Ontario Division and Greater Winnipeg Gas were the major contributors to these results. Gaz Metropolitain, while experiencing a reduction in profitability to $1.8 million net income, did nonetheless make considerable progress during the year and should contribute increased profits in the current and coming years.

During the year under review, Greater Winnipeg Gas started a program of investment in oil and natural gas exploration in western Canada. Making such an investment attractive as a potential source of non-regulated income, were higher wellhead prices for oil and natural gas and the incentive for certain Canadian corporations, including gas distribution companies, to invest in the development of Canadian resources provided by Section 83A of the Federal Tax Regulations. Total investment was approximately $900,000 in 1970 and is expected to be $1.5 million in 1971. CIGOL is managing these investments and to date Greater Winnipeg Gas has participated in two oil discoveries in Alberta and a gas discovery in British Columbia.

The Ontario Division's results were very satisfactory in 1970 with appreciable gains in gas sales, revenues and earnings. Prospects for further progress within this division are encouraging as a result of increasing industrial development in the Province of Ontario and the growing preference for natural gas as an economic alternative to high pollution fuels.

Canadian Industrial Gas & Oil Ltd.

Canadian Industrial Gas & Oil Ltd. had an active and successful year in 1970 with revenues of $33,369,000; its contribution to the income of Northern and Central increased 5% to $5,460,000.

The company participated in the drilling of 86 wells in 1970 of which 24 were successfully completed as oil wells and 15 as gas wells. In addition, this company made two acquisitions in

the energy distribution field which should result in increased profits in the future.

At present, CIGOL maintains varied interests in approximately 16,204,000 gross acres, plus over-riding royalty interests in an additional 643,000 gross acres. These properties are located in areas of promising geology throughout Canada and in offshore areas, including the North Sea. Exploration activity on selected properties is being accelerated in partnership with other major companies.

Rate Applications

A factor which will have a direct bearing on future profits of Northern and Central is, of course, the allowable rate of return which the provincial regulatory authorities will permit in our utility service areas. As previously mentioned, the company was allowed rate increases in 1970 in Manitoba and Quebec. At present, an application for a rate increase in Ontario has been heard and we are awaiting the decision of the Ontario Energy Board.

Our companies in Manitoba and Quebec, in their applications, indicated a need for a higher rate of return. I would like to underline that the allowable rate of return is extremely important as this will reflect in a stronger utility, better service to customers, and an improved return to shareholders. I would hope that this need for a higher rate of return will be recognized in Ontario.

Rate applications involve considerable costs to the company and in some cases considerable delay. For example, the Ontario application has been under consideration for over one year and has involved costs to the company of approximately $300,000. Such delay and expense must be considered as an unfair burden to customers and shareholders, both of whom must ultimately bear the cost. Such a state of affairs only serves to underscore the validity of the corporation's repeated arguments to regulatory authorities calling for the inclusion of provisions for interim rate adjustments within utility regulatory legislation.

Closely associated with the question of allowable rate of return is the pro rata increases to utility customers when the cost of gas to the utility is raised by its supplier.

At present, a rate increase application by TransCanada PipeLines is under consideration by the National Energy Board. Northern and Central is an active intervenor in this case, not with prejudice or bias, but rather on the basis that a rate increase to TransCanada should be fair and equitable to all markets in Canada and be accompanied by immediate rate adjustments for distribution utilities.

It is hoped that the decision to be handed down will acknowledge the need to spread any increased costs of gas over all those involved in its transmission, distribution and use, and not unduly burden any one segment of this group. This approach would be in the best interest of all concerned.

Aims and Objectives

And now I would like to take a moment to talk about our philosophy, aims and objectives.

Your corporation has very successfully established a broad base in the energy industry. A thorough corporate analysis and review, indicates that the potential for growth within the Northern and Central group of companies is excellent. Not excluding the possibility of further acquisitions within the energy field, we have the firm objective of maximizing the profits from each of our existing operations, thereby increasing the return to shareholders. The chart on my right indicates that we have maintained over the ten years, from 1960 to 1970, a 12% compounded growth rate in earnings per share, after taxes. We intend to continue this rate of growth if not to exceed it.

In the years ahead, utility earnings should substantially increase as a result of the rate increases in Manitoba and Quebec: the increasing long term demand for natural gas because of the ever expanding needs for all forms of energy in North America; the growing public concern about air pollution; the position in the Montreal market – only one-third penetrated; the dominant position in growing areas of Ontario; the steady growth of the Winnipeg market; the availability, at reasonable costs, of long term supplies of western Canadian natural gas for the Canadian market, as indicated by recent export and pricing policies established by the National Energy Board. In addition, the outlook for Canadian Industrial Gas

& Oil Ltd. is good with its broad participation in promising oil and gas acreage as well as the potential for increased oil, natural gas and liquefied petroleum production and sales.

1971 First Quarter Results

For the year 1971, the prospects for Northern and Central are very encouraging and increased revenues and profits can be anticipated. In support of this forecast, I can report that preliminary figures for the first three months of the current year show an increase in income of 15%, to $11,622,000, and an increase in revenues, to $62,325,000, a gain of 10% over the corresponding period last year.

In summary, we look forward with confidence to sustained progress of Northern and Central in the remainder of the current year and to the opportunities available to the company in meeting the ever-growing energy demands of the Canadian economy in the future.